

USAWC STRATEGY RESEARCH PROJECT

**DEPARTMENT OF DEFENSE CONTRACTING:
CONSIDERATIONS FOR SELECTING CONTRACT TYPE**

by

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This SRP is submitted in partial fulfillment of the requirements of the Master of Strategic Studies Degree. The views expressed in this student academic research paper are those of the author and do not reflect the official policy or position of the Department of the Army, Department of Defense, or the U.S. Government.

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ABSTRACT

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Selection of the type of contract is a primary mechanism DOD contracting professionals use to manage the risks inherent in the procurement of materiel and services. The contract type determines the degree of risk that is allocated between the contractor and the DOD. The contract type also establishes the degree that unique government requirements are applicable to the procurement. The objective for DOD contracting professionals is to select a contract type that results in reasonable contractor risk with the greatest incentive for efficient and economical contract performance (best value).

DOD contracting professionals do not always adequately take into account the effect of the terms and conditions when planning for the contract type used for procurement of materiel and services. This results in contracting decisions that impose a greater total cost to the DOD than appropriate to mitigate contract risk. This leads to procurement of materiel and services that do not provide the best value to the DOD.

This research paper addresses the process for selection of contract type, the major DOD requirements based on contract type, problems associated with the consideration of these requirements during selection of contract type, and recommended improvements

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DEPARTMENT OF DEFENSE CONTRACTING: CONSIDERATIONS FOR SELECTING CONTRACT TYPE

Annually, the Department of Defense (DOD) procures materiel and services that range from complex development of unique weapon systems to readily available commercial products. The acquisition of materiel and services by the DOD is a complicated process governed by law and federal, DOD, and service regulations, policies and guidance. The basic goals of these governing laws, regulations, policies and guidance are to ensure that the DOD procurement process acquires the materiel and services necessary to meet DOD and national goals, and to protect the public interest by procuring materiel and services at their best value.

Like any commercial procurement, procuring materiel and services for the DOD involves varying degrees of risk. This risk can be grouped in three broad categories: the degree that the procured item or service meets the user's requirements, the degree that the quantity procured is sufficient to meet all user requirements, and the degree that the total cost of procurement represents a best value to the government.

In many cases, the degree of risk associated with DOD procurement is greater than the risk in commercial procurements. This greater risk can result because the materiel and services are unique to the DOD, the actual materiel and services requirements are unknown at the time of the procurement, a limited marketplace exists for procuring required DOD materiel and services, and the effect of governing laws and regulations on fair and reasonable value.

The above risks associated with DOD procurement has led over the last few decades to the imposition of unique DOD procurement requirements and processes to mitigate risk that have resulted in a loss of focus on best value.¹ These include unique requirements for DOD procurement professionals when planning for, negotiating and awarding contracts; unique requirements for contractors during performance of DOD contracts; and an extensive management and overhead structure in the DOD to ensure that these unique requirements are followed.²

The result of these unique DOD procurement requirements and processes is a limitation of contractors willing to enter into contracts with the DOD and the inability of the DOD to procure materiel and services at their best value. The recognition and elimination of these results has become a key aspect of procurement reform initiatives within the DOD.

"Civil military integration, eliminating the distinction between doing business with the government and other buyers, is critical to meeting future military, economic, and policy objectives. In order to accomplish civil-military integration of a national industrial base, the DOD

must be able to adopt the business processes of world-class customers and suppliers and stop applying government-unique terms and conditions to the maximum extent practicable.”³

Selection of the type of contract is a primary mechanism DOD contracting professionals use to manage the risks inherent in the procurement of materiel and services. The contract type determines the degree of risk, and any associated costs of the risk, that is allocated between the contractor and the DOD.⁴ The contract type also establishes the degree that unique government requirements are applicable to the procurement, such as determination of the reasonableness of the contract price, financial management requirements, DOD oversight during the administration of the contract effort, and terms of payment. The objective for DOD contracting professionals is to select a contract type that results in reasonable contractor risk with the greatest incentive for efficient and economical contract performance (best value) both to the contractor and to the DOD.⁵

In order to select the contract type that best meets the above objective, the DOD contracting professional must understand the total costs resulting from the contract type for the procurement. This total includes both the costs directly associated with the contract deliverable and the costs associated in carrying out any unique requirements (terms and conditions) associated with the contract type.

The major terms and conditions included in the contract type are those primarily associated with DOD oversight of the contractor’s effort and administration of the contract through completion, verification that the contractor’s price is fair and reasonable, and the payment of the contractor for contract effort. The DOD organizations primarily involved in these costs are the Defense Contract Management Agency (DCMA), the Defense Contract Audit Agency (DCAA), and the Defense Finance and Accounting Service (DFAS), respectively.

DOD contracting professionals do not always adequately take into account the effect of the terms and conditions when deciding on the contract type used for procurement of materiel and services. This results in contracting decisions that impose a greater total cost to the DOD than appropriate to mitigate contract risk. This leads to procurement of materiel and services that do not provide the best value to the DOD.

This research paper will address the process for selection of contract type, the major DOD requirements based on contract type, problems associated with the consideration of these requirements during selection of contract type, and recommends improvements for selecting the contract type.

TYPES OF CONTRACTS

The Federal Acquisition Regulation (FAR) provides a wide variety of contract types for use by the DOD in the procurement of materiel and services. These contract types vary according to--

- The degree and timing of the responsibility assumed by the contractor for the costs of the performance.
- The amount and nature of the profit incentive offered to the contractor for achieving or exceeding specified standards or goals.⁶

Contract types used by the DOD are grouped into three general categories: fixed-price contracts, cost-reimbursement contracts, and labor-hour (LH) and time-and-materials (T&M) contracts.⁷ Fixed-price contracts allocate all or the majority of the risk of the cost of performance primarily to the contractor. Cost-reimbursement contracts allocate the majority of the risk of the cost of performance primarily to the DOD and the contractor's negotiated profit (fee) is fixed. LH and T&M contracts divide the majority of contract risk between the contractor and the DOD. They contain fixed labor rates but only estimates of the number of hours required during the contract effort. Fixed-price and cost-reimbursement contract categories are further divided into specific contract types discussed below.⁸

FIXED-PRICE CONTRACTS

A contractor entering into a fixed-price contract with the DOD agrees to deliver the required materiel or service at a price not to exceed the maximum amount stipulated in the contract. Contract types in this category include:

- Firm-fixed Price (FFP)
- Fixed-price economic price adjustment (FPEPA)
- Fixed-price award-fee (FPAF)
- Fixed-price Incentive Firm (FPIF)
- Fixed-price incentive with successive targets (FPIS)
- Fixed-price contract with prospective price redetermination (FPRP)
- Fixed-ceiling-price contract with retroactive price redetermination (FPRR)
- Firm fixed-price level of effort term contract (FFPLOE)

The risk associated with these contracts is primarily assumed by the contractor. These contracts provide a positive profit incentive to the contractor for cost control and labor efficiency.

The table below compares fixed-price contract types for the following criteria:⁹

- Conditions for use

- Principal risk to the DOD
- Required contract elements
- Typical DOD materiel and service use
- Contractor obligation
- Contractor incentive
- FAR limitations for use
- Contract type variations

	FFP	FPEPA	FPIF	FPAF	FPRP
Used when	Requirement is well defined; contractor is experienced; stable market; insignificant financial risks	Significant risk to market prices due to industry-wide factors beyond the contractor's control; Dollars at risk outweigh administrative burden	Ceiling price can be established that covers the risks inherent in the work effort; profit sharing formula motivates contractor to control costs	Acceptance criteria can be fairly evaluated; fee will provide meaningful incentives and justify related administration burden	DOD requires firm commitment for materiel or services during subsequent years; dollars at risk outweigh administrative burden
Principal Risk to DOD	None. Contractor assumes all cost risk	Unstable market prices for labor or materiel over period of contract	Moderately uncertain contract labor or materiel requirement	Contractor may not meet acceptance criteria	Costs of performance after first year cannot be accurately estimated
Required contract elements	Firm fixed-price for all contract deliverables	Fixed-price; ceiling for upward adjustment; formula for price adjustment for market conditions	Ceiling price; target cost; target profit; delivery and quality targets; profit sharing formula	Firm fixed-price; performance evaluation standards; procedures for calculating fee based on performance standards	Fixed-price for first period; Proposed subsequent periods; Timetable for pricing next periods.
Typical uses	Commercial materiel and services	Commercial materiel and services during periods of market instability	Production of a major system based on a prototype	Performance-based contracts for materiel and services	Long-term production of spare parts
Contractor obligation	Provide acceptable deliverable at specified time, place and price	Provide acceptable deliverable at specified time, place and adjusted price	Provide acceptable deliverable at specified time, place and at or below ceiling price	Perform at the time, place, and price fixed in the contract	Provide acceptable deliverable at specified time, place and at price established for each period

Contractor incentive	Additional profit for reduction in performance costs	Additional profit for reduction in performance costs	Higher profit for completing work below ceiling price and/or meeting objective performance targets	Additional profit for reduction in performance costs; additional fee for meeting performance standards	Additional profit for reduction in performance costs for performance periods
FAR limitations	Generally not appropriate for research & development	Must be justified	Must be justified; must be negotiated; adequate accounting system; cost data must support targets	Must be negotiated	Must be negotiated; adequate accounting system; prompt redeterminations
Variants	FPLOE		FPIS		FPRR

TABLE 1. COMPARISON OF FIXED-PRICE CONTRACT TYPES. ¹⁰

COST-REIMBURSEMENT CONTRACTS

A contractor entering into a cost-reimbursement contract with the DOD agrees to deliver its best effort to provide the materiel or service stipulated in the contract. The contractor is reimbursed the allowable costs incurred in providing its best effort up to a funding limitation stipulated in the contract. The contractor is also paid a fee (profit) for providing its best effort as stipulated in the contract terms. Contract types in this category include:

- Cost (CR)
- Cost-sharing (CS)
- Cost-plus-fixed-fee (CPFF)
- Cost-plus-award-fee (CPAF)
- Cost-plus-incentive-fee (CPIF)

The risk associated with these contracts is primarily assumed by the DOD. These contracts provide varying degrees of positive incentive to the contractor for cost control and labor efficiency.

LH AND T&M CONTRACTS

LH and T&M contracts provide for procuring materiel and services when it is not possible to accurately estimate the extent or duration of the materiel or service required or when the DOD cannot anticipate the total costs with any reasonable degree of confidence. These contracts procure materiel and services based on--

- Direct labor hours at fixed hourly rates that include wages, overhead, general and administrative expenses, and profit.
- Materials at cost, including materiel handling costs, if appropriate.

The risk associated with these contracts is primarily assumed by the DOD once hourly rates and materiel costs are fixed in the contract. These contracts provide no positive profit incentive to the contractor for cost control or labor efficiency.

The table below compares cost-reimbursement contracts (including LH and T&M contracts) with the same criteria used for fixed-price contracts.¹¹

	CPIF	CPAF	CPFF	CR or CS	LH or T&M
Used when	Objective relationship can be established between the fee and measures of contract performance	Objective relationship between fee and measures of performance are not feasible. Subjective standards can be fairly applied	Relating fee to measures of contract performance is unworkable or of marginal utility	Contractor expects substantial compensating benefits for absorbing part of the cost and/or foregoing fee; non-profit contractor	No other type of contract is suitable due to contract delivery requirements or other factors
Principal Risk to DOD	DOD assumes the majority of the risk inherent in the contract due to highly uncertain and speculative labor, materiel and other requirements necessary to perform the contract.				
Required contract elements	Target cost; minimum, maximum and target fee; formula for adjusting fee based on actual costs and/or performance	Target cost; Standards for evaluating performance; Base and maximum fee; procedures for adjusting fee based on performance against standards	Target cost; fixed fee	Target cost; If CS, an agreement on the DOD share of the cost; no fee	Ceiling price; per-hour labor rate that includes overhead and profit; provisions for reimbursing direct material costs
Typical uses	Research and development of the prototype for a major system	Large scale research study	Research study	Joint research with non-profit institutions	Emergency procurement of repairs
Contractor Obligation	Make a good faith effort to meet the contract requirements within the estimated cost and schedule				Make a good faith effort to meet the contract requirements within the ceiling price

Contractor incentive	Realize a higher fee by completing work at a lower cost and/or by meeting other objective performance targets	Realize a higher fee by meeting subjective performance standards	Realize a higher rate of return (fee divided by total cost) as total cost decreases	If CS, shares in providing a deliverable of mutual benefit	None
FAR limitations	Must be justified; must be negotiated; contractor must have an adequate accounting system; DOD must exercise surveillance during performance to ensure efficient methods and cost controls; Statutory and regulatory limits on fee; must include cost limits				Labor rates must be negotiated; must be justified; DOD must exercise surveillance to ensure efficient performance
Variants			Completion or term		

TABLE 2. COMPARISON OF COST-REIMBURSEMENT CONTRACT TYPES.¹²

REQUIREMENTS FOR SELECTION OF CONTRACT TYPE

DOD personnel involved in the selection of the type of contract used to procure materiel and services can range from a large and complex organization for major weapon system procurement to a few individuals purchasing routine materiel and services. However large and diverse the personnel involved, the final selection of the contract type is the responsibility of the Procuring Contracting Officer (PCO) representing the requiring activity. The PCO is responsible for ensuring that the type of contract selected, and the terms and conditions of the contract, meet a large number of regulatory and policy requirements.¹³

REGULATORY REQUIREMENTS

The FAR and Defense Federal Acquisition Regulation Supplement (DFARS) contain numerous requirements affecting the selection of contract type. These requirements identify the conditions of the procurement necessary for use of each contract type (applications), restrictions on the use of each type of contract (limitations) and required contract clauses that must be incorporated into each contract type (terms and conditions). These regulatory applications and limitations for selection of contract type can be categorized to four general requirements--

- Commercial items must be procured using a fixed-price contract type.¹⁴
- Fixed-price contracts for non-commercial items requires the PCO to establish a fair and reasonable price based on price competition, comparison with previous competitive procurements, available cost or pricing information, or the contractor is

willing to accept a fixed-price based on reasonable estimates of the cost impact of performance uncertainties.¹⁵

- Cost-Reimbursement contracts for non-commercial items may be used only when the contractor's accounting system is adequate for determining the costs applicable to the contract; and appropriate Government surveillance will provide reasonable assurance that efficient methods and effective cost controls are used.¹⁶
- LH and T&M contracts for materiel and services may be used only when it is not possible at the time of the contract to accurately estimate the extent of duration of the work or anticipate costs with any degree of reasonableness; and appropriate Government surveillance will provide reasonable assurance that efficient methods and effective cost controls are used.¹⁷

POLICY REQUIREMENTS

There are a large number of policy requirements that a DOD PCO must consider when selecting contract type. These policies are established by the FAR and DFARS, by the Office of Federal Procurement Policy (OFPP), and by the services and DOD agencies. The FAR establishes the overarching policies that effect contract type selection. The main theme of the FAR policies requires the PCO to exercise sound judgment by determining the contract type and price (or estimated cost and fee) that will result in reasonable contractor risk and the greatest incentives for efficient and economic performance.¹⁸

OFPP, services, and DOD agencies have issued many policies with the intent to reform the DOD acquisition process. These policies focus on three major areas that affect contract type selection:¹⁹

Maximize use of commercial items

DOD and service policies direct the procurement of commercially available items to meet DOD materiel and service requirements to the maximum extent possible in order to reduce DOD development costs and to leverage the commercial industrial base for DOD requirements.

Streamline DOD contract requirements

Acquisition reform policies focus on reducing and streamlining the unique requirements applied by DOD when procuring materiel and services in order to reduce the total cost to DOD for procurements, enable contractors to integrate the military business with their commercial business, ensure greater access to commercial technology, materiel and services, and eliminate unique requirements that do not mitigate any risk accepted by the DOD in the contract.²⁰

Reduce total costs for DOD procurement

Current DOD policies place a large emphasis on reducing the total costs for both the DOD and contractors to conduct business in order to maximize the use of limited DOD procurement and administrative budgets.²¹ These total costs are primarily a result of the administration and management burdens to both the contractor and DOD acquisition professionals to substantiate that the risks inherent in the contract relationship are being managed efficiently and economically, and are in the DOD's best interest.²²

UNIQUE DOD REQUIREMENTS BY CONTRACT TYPE

The FAR and DFARS contain many unique requirements in order to ensure that the DOD obtains materiel and services at the best value and that the contractual risks shared by the contractor and DOD are realistic, fair and reasonable.²³ These unique requirements can be grouped into four general categories: determination of price or cost reasonableness, financial management, contract administration, and contractor financing and payment. The sections below outline these four general categories of requirements for fixed-price and cost-reimbursement contract types.

FIXED-PRICE CONTRACTS

The DOD unique requirements applicable to fixed-price contracts can be relatively minimal compared to cost-reimbursement contracts because the contractor assumes the majority of the risk inherent in performing the contract.

Price Reasonableness

For fixed-price contracts, the DOD PCO is required to determine that the contract price is fair and reasonable. This determination is based on either adequate price competition, or a subjective evaluation based on an analysis of a price proposal submitted by the contractor (price analysis).²⁴ This price analysis generally does not involve evaluation of separate cost and profit elements (cost analysis) unless it is required by a negotiated variation in the fixed-price contract, such as FPIF.²⁵ The final contract price is considered sufficient by both the DOD and the contractor to cover all of the contractor's expenses in performing the contract to include profit.

Financial Management

Public Law 100-679 established rules, regulations and Cost Accounting Standards (CAS) that are applicable to all executive agencies, including the DOD, and its contractors and

subcontractors for estimating, accumulating, and reporting costs.²⁶ CAS requirements are not applicable for fixed-price contracts that meet one of the following conditions:

- Any contract awarded to a small business (defined by FAR Subpart 19.3)
- Any FFP contract awarded based on adequate price competition without submission of contractor price or cost data
- FFP or FPEPA contracts for the acquisition of commercial items
- The contract is not in excess of \$500,000 and is awarded by negotiation (price or cost analysis)
- The contract is less than \$7.5 million, provided that the business unit of the contractor is not performing any CAS covered contracts or subcontracts valued at \$7.5 million or greater
- The contract is executed and performed entirely outside the United States its territories, and possessions²⁷

Contract Administration

Since the contractor assumes the risks inherent in meeting the performance requirements in fixed-price contracts, the level of DOD oversight during performance is generally minimal. This oversight is usually limited to periodic and final inspection of the contract deliverable, monitoring completion by the contract delivery date, and evaluation of any contract incentives such as profit sharing or award-fee.²⁸ The administration of fixed-price contracts may also involve the verification and validation of any interim payment of the contractor prior to final delivery as discussed below.

Contractor Financing and Payment

FAR and DOD policy is to pay for fixed-price contracts no later than 15 days after receipt of the contract deliverable. Because DOD contracts for materiel and services may involve long periods of performance, DOD uses contract financing methods to help offset any additional costs incurred by the contractor due to the period of performance.²⁹ For DOD fixed-price contracts, payments can be made based on the contractor meeting intermediate performance-based progress toward the final deliverable. The amount of these progress payments is usually based on the PCO's determination of the relative value of the performance-based progress.

COST-REIMBURSEMENT CONTRACTS

The DOD unique requirements applicable to cost-reimbursement contracts are extensive. These requirements are necessary in order to mitigate the risk assumed by the DOD in the

contract relationship, and to ensure that the contractor is making a good faith effort to meet the DOD's needs while using efficient methods and cost controls.³⁰

Cost Reasonableness

Since cost-reimbursement contracts are used when the contract performance does not permit a total price to be determined with sufficient accuracy, The FAR and DFARS require the contractor to submit complete, accurate, and current data supporting all proposed costs to meet the contract performance requirements and any proposed fee (cost proposal). The PCO must perform a cost analysis of the contractor's proposal, including any other information necessary to determine the realism of the proposed costs, to make a determination of the reasonableness of the total negotiated contract costs.³¹ This analysis involves a detailed evaluation of all of the contractor's proposed costs including:

Direct Costs

The direct costs required to perform the contract effort. FAR 31.202 define direct costs as any cost specifically identified to the performance of the contract that is not included in the costs of performing other contracts.

Indirect Costs

The contractor must also propose the percentage of their indirect costs that will be charged to the contract effort. FAR 31.203 defines indirect costs as those that are not directly identifiable with a single cost objective (i.e. contract), but identified with two or more cost objectives (contracts). Indirect costs include: overhead costs incurred for an identifiable unit or activity of the contractor's organization such as department supervision, training of employees, and employee fringe benefits, and General & Administrative (G&A) expenses necessary for the overall operation of the business as a whole, such as top management functions for direction over all personnel, departments, facilities, and activities of the contractor.³²

Fee

The Contractor must propose his required fee (profit) for performing the contract effort and the basis for any incentives for adjusting the fee based on the anticipated contract type.³³

Financial Management

CAS requirements are not applicable for cost-reimbursement contracts that meet one of the following conditions:

- Any contract awarded to a small business (defined by FAR Subpart 19.3)

- The contract is not in excess of \$500,000 and is awarded by negotiation (price or cost analysis)
- The contract is less than \$7.5 million, provided that the business unit of the contractor is not performing any CAS covered contracts or subcontracts valued at \$7.5 million or greater
- The contract is executed and performed entirely outside the United States its territories, and possessions³⁴

Contract Administration

Since the DOD assumes the risks inherent in meeting the performance requirements in cost-reimbursement contracts, the level of DOD oversight during performance is significant. This oversight is normally the responsibility of an Administrative Contracting Officer (ACO) appointed to administer the contract. FAR Part 42 identifies 70 functions under the responsibility of the ACO that are either required or recommended based on the terms and conditions in the contract. These contract administration functions can be grouped under four broad categories:

- Surveillance and assessment of the contractor's compliance with the cost, schedule and technical performance requirements of the contract effort
- Surveillance and assessment of the contractor's business practices required by the terms and conditions of the contract, i.e. the contractor's quality, safety, and purchasing programs
- Surveillance and assessment of the contractor's financial systems that identify the direct and indirect costs of the contract effort
- Analysis and approval of any necessary modifications to the terms and conditions of the contract³⁵

Contractor Financing and Payment

Since the DOD assumes the majority of the cost risk in cost-reimbursement contracts, the unique requirements for contractor financing and payment can be extensive. The DOD allows the contractor to submit interim billing payments, based on costs incurred or cost based progress, to help offset the contractors incurred direct costs and estimated allowable indirect costs for periods during the contract effort.³⁶ The amount paid against the interim billing for direct and estimated indirect costs is based on a determination by the ACO, and substantiated by an audit of the contractor's billing system and contract costs.³⁷ The final payment (completion voucher) to the contractor for a cost-reimbursement contract effort requires a final

audit of all direct and indirect costs, and any necessary adjustment due to differences between interim billing of estimated indirect costs and the actual indirect costs resulting from the contract performance.³⁸

CONSIDERATION OF DOD UNIQUE REQUIREMENTS DURING CONTRACT SELECTION

The DOD PCO must carefully consider the effects of unique requirements on the total cost to the DOD when procuring materiel and services. The total cost is dependant on the nature and availability of the materiel or service required, the risk involved in procurement, the contractual requirements necessary to mitigate any risk assumed by the DOD or the potential contractor, and the efficient and effective completion of the contract. This consideration requires detailed planning and involves expertise in all aspects of the contractual relationship. The PCO must use a multi-functional team of experts and a detailed planning process to select the appropriate contract type. The goal is to acquire best value materiel and services by minimizing the total cost of the contract.

ACQUISITION PLANNING

The primary mechanism the DOD PCO uses to ensure all regulatory and policy requirements are met when selecting the contract type is through acquisition planning. Planning for the acquisition of all materiel and services is a requirement directed by the FAR and DFARS in order to promote the procurement of commercial and non-developmental items to the maximum extent practicable, and to obtain the maximum level of competition with regard to the nature of the required materiel and services. The goal of acquisition planning is to obtain the best value for the procurement. This planning must begin as soon as the need is identified and integrate the efforts of all personnel responsible for all significant aspects of the acquisition, including requirements generation, proposal evaluation, source selection, oversight of the contractor's performance, and administration of the contract, in order to ensure that the DOD meets its needs in the most economical and timely manner.³⁹

The DFARS requires formal written acquisition plans for development programs when the total cost of all contracts for the program is estimated at \$5 million or greater; and for acquisition of production or services when the total cost is estimated for \$15 million or greater for any fiscal year or \$30 million or greater for all production years. Acquisition plans may be written on a program or individual contract basis for procurements that do not meet the above thresholds.⁴⁰

Acquisition plans are composed of two major parts: The acquisition background and objectives, and the plan of action.

Acquisition Background and Objectives

The background and objectives portion of the acquisition plan identifies--

- A statement of need that summarizes the technical and contractual history of the acquisition including feasible alternatives and the impact of prior acquisitions on those alternatives.
- Significant conditions affecting the acquisition including compatibility with existing or future DOD acquisitions and any constraints due to cost, schedule, and capability or performance.
- The required capabilities or performance characteristics or standards.
- The delivery or performance period requirements, including any justification for not providing for full and open competition.
- Any trade-offs among cost, capability, and performance and schedule goals.
- The technical, cost and schedule risks to the DOD, and planned efforts to reduce risk.
- Acquisition streamlining efforts, including industry recommendations for the most appropriate application and tailoring of contract requirements.⁴¹

Plan of Action

The plan of action portion of the acquisition plan--

- Indicates the potential sources for the required materiel or service, including any FAR or DFARS required sources, and any impacts the procurement requirements will have on the current supplier base.
- Describes how competition will be sought, promoted and sustained throughout the course of the acquisition, including a justification if full and open competition will not be used.
- Discusses the procedures and evaluation factors for contract award, including the relationship of the evaluation factors to the acquisition objectives.
- Discusses the factors used in selection of the contract type, the terms and conditions included in the contract, any planned deviations to FAR or DFARS requirements, and any other contracting considerations.
- Includes budget estimates for the acquisition, how they were derived and the schedule for obtaining adequate funds when they are required by the contract.
- Identifies the reasons for any particularly short performance or delivery schedule due to urgency of the requirement.

- Discusses, if appropriate, the management system that will be used by the DOD agency to monitor the contractor's effort.
- Discusses any test and evaluation requirements and the contractor's and DOD's test program.
- Discusses the level of DOD contract administration required by the contract that is anticipated or currently performed, and any changes proposed by DOD personnel responsible for contract administration.⁴²

Completion of the acquisition plan for each DOD procurement leads to a thorough analysis of the requirement, potential commercial sources, how any risk inherent in the procurement will be shared between the contractor and DOD, and the contracting strategy including the contract type. The results from the acquisition planning process establish the DOD unique processes and requirements that will be applied to the contractual relationship between the DOD and the contractor.

DOD ORGANIZATIONS INVOLVED IN ACQUISITION PLANNING

Successful completion of acquisition planning must involve expertise in the necessary DOD oversight of the contractor's effort and administration of the contract through completion, the verification that the contractor's price is fair and reasonable, and the payment of the contractor for contract effort, in order to meet the goals of the planning process. This combined expertise is rarely contained entirely in the PCO's organization. It involves expertise in the three DOD organizations listed below.

Defense Contract Management Agency (DCMA)

DCMA provides the contract management services included in FAR part 42 throughout the acquisition lifecycle to include contractor compliance with cost, delivery, technical, quality and contract terms for contracts assigned for management; accepting products and services on behalf of the Government; providing program and technical support; and ensuring contractors are paid. DCMA serves as DOD's single face to industry in contractors' plants worldwide, providing the DOD with invaluable insights throughout the acquisition process.⁴³ DCMA employs approximately 11,655 full-time equivalent positions with an annual budget totaling \$1.1 billion.⁴⁴ The operations personnel in DCMA include contract administrators, cost and price analysts, professional and systems engineers, software and hardware quality assurance personnel, industrial and manufacturing specialists, program integrators, and other specialists.⁴⁵

Defense Contract Audit Agency (DCAA)

DCAA is responsible for providing audit and financial advice services regarding contracts and subcontracts to all DOD components responsible for procurement and contract administration to assist them in achieving fair and reasonable contract prices and assuring compliance with contractual terms and conditions.⁴⁶ The services include: pre-award forward pricing effort, incurred cost audits, economy and efficiency audits of contractor operations, special audits requested by contracting officers, defective pricing reviews of cost or pricing data, CAS compliance audits, and other direct audit effort.⁴⁷ DCAA employs approximately 4,096 full-time equivalent positions with an annual budget totaling \$383 million.⁴⁸ DCAA operations personnel are primarily accounting and auditing professionals.

Defense Finance and Accounting Service (DFAS)

DFAS provides financial funds management, accounting and contractor payment services for DOD contracts. These services include contractor payment by the terms and conditions of the contract, reconciliation of total contract payments prior to final contract completion, and disbursement of payments in compliance with applicable federal laws and DOD regulations.⁴⁹ These laws and regulations establish terms and conditions regarding the availability, classification of, and use of procurement funds, and the maximum time allowed for disbursement.⁵⁰ DFAS has an annual budget of \$1.6 billion, of which approximately \$270 million is allocated to efforts directly involved with the payment of DOD contracts.⁵¹

PROBLEMS ASSOCIATED WITH SELECTION OF CONTRACT TYPE

The problems associated with selecting the contract type that will provide the best value to DOD are primarily due to failure to conduct adequate acquisition planning and the unnecessary and inefficient inclusion of DOD unique terms and conditions in the contract.⁵²

FAILURE TO CONDUCT ADEQUATE ACQUISITION PLANNING

Adequate planning to meet the intent of the FAR and DFARS requires significant participation of all DOD organizations involved throughout the acquisition. Labor and budget data for DCMA and DCAA suggest that adequate planning is not always occurring. For fiscal year (FY) 2003, DCMA employees recorded 187 work years in the Pre-Contractual category of the DCMA Performance Labor and Accounting System (PLAS). This is approximately 1.7 percent of the FY 2003 total work years for DCMA.⁵³ Estimated FY 2003 budget data for DCAA includes 988 work years for pre-contract assistance. This is approximately 25 percent of the total estimated FY 2003 work years for DCAA.⁵⁴

DFAS does not collect labor and budget data in a manner that leads to analysis of the percentage of work effort for pre-contract assistance. However, there is significant anecdotal evidence suggesting that DFAS involvement in acquisition planning is not adequate. This includes continuing problems with accurate payment of DOD contracts by DFAS due to ambiguous payment instructions included in the contract.⁵⁵

UNNECESSARY CONTRACT TERMS AND CONDITIONS

While the FAR and DFARS require mandatory inclusion of certain requirements by contract type, the DOD PCO and ACO have broad leeway for including the necessary terms and conditions for contract execution. There is significant evidence that a large number of DOD contracts contain terms and conditions that are unnecessary for the efficient and effective completion of the contract effort. These unnecessary terms and conditions control the requirements for the contractor's work effort, the business requirements and processes of the contractor's organization, and the administration of the contract type by both the DOD and the contractor.⁵⁶

DOD unique terms and conditions become unnecessary when they do not effectively mitigate any risk to either the DOD or the contractor, when they subjugate or replace the contractor's adequate business practices, and when they provide no added benefit for meeting the DOD customer's requirement.⁵⁷

CONCLUSION

The effective selection of the contract type, and the contract's necessary terms and conditions, is critical to meeting the DOD policy requirements to maximize use of commercial items, streamline DOD unique requirements and reduce the total costs of DOD procurements. DOD acquisition professionals must conduct detailed acquisition planning in order to select the most effective contract type to accomplish these policy objectives, meet mandatory legal and regulatory requirements, and effectively mitigate any risk to the DOD. This is necessary to select the most appropriate contract type regardless of the contract value or the requirement for a written acquisition plan.

The use of all DOD personnel involved in the acquisition lifecycle is an essential part of detailed acquisition planning. The involvement of DCMA, DCAA, and DFAS expertise in all acquisition planning is critical to the PCO's understanding of the total cost to the DOD resulting from the contract type and any included DOD unique requirements. Their involvement is also critical to the PCO's understanding of the actual risks to the DOD and how the contract type and unique requirements will affect those risks. Not involving DCMA, DCAA, and DFAS during

acquisition planning can result in the selection of an improper contract type with unnecessary terms and conditions that has a greater chance of imposing a greater cost burden than the value of the procured materiel or service. It also may exclude potential competitors who do not have the necessary business processes that can meet the DOD unique requirements.⁵⁸

The process and factors involved in selecting the most effective contract type is complex. It involves professional expertise in all aspects of the contract lifecycle and an understanding of DOD unique and commercial business practices. Current professional training for DOD procurement professionals does not adequately provide the expertise necessary to effectively select the most effective contract type and the effect of DOD unique terms and conditions. DOD professional training for PCOs focuses more on the identification of, and adherence to, the mandatory requirements of the FAR and DFARS. The DOD training for ACOs and other professionals involved in contract administration focuses on contractual adherence to the contract terms and conditions and monitoring the requirements for contract payment.⁵⁹

A stronger emphasis on the process and considerations in selecting the contract type must be incorporated into the professional training program for DOD procurement professionals. Professional training needs to focus more on how unique DOD requirements affect the contract through the procurement, to what extent they mitigate the risks inherent in the contract, and their effects on the total costs of the procurement. This professional training must also focus on current and emerging commercial practices and how they are used to mitigate risk within the commercial industry in order to help identify when unique DOD requirements are unnecessary.

A stronger emphasis by the DOD acquisition policy community on integrating DCMA, DCAA, and DFAS professionals into the acquisition planning process for the procurement for all materiel and services is also necessary. Requiring the involvement of all of these organizations will enable a more effective selection of the contract type, and the inclusion of only those DOD unique requirements necessary to provide the best value procurement of materiel and services.

WORD COUNT= 5,538

ENDNOTES

¹ Edward L. Will, "Paving the Way for Price-Based Acquisition," *Acquisition Review Quarterly* (1999), available from <<http://www.dau.mil/pubs/arq/99arq/will.pdf>>; Internet; accessed 20 January 2004.

² These unique requirements are identified in the Federal Acquisition Regulation (FAR), Defense Federal Acquisition Regulation Supplement (DFARS), and various DOD and Service specific regulations and policies.

³ Department of Defense, *Chapter 15, Acquisition Reform*, available from <<http://www.defenselink.mil/execsec/adr1999/chap15.html>>; Internet; accessed 13 January 2004.

⁴ Department of Defense, *Defense Procurement and Acquisition Policy: Contract Pricing Reference Guides*; available from <<http://www.acq.osd.mil/dpap/contractpricing/vol14chap1.htm>>; Internet; accessed 13 January 2004.

⁵ Ibid.

⁶ General Services Administration, *Federal Acquisition Regulation, Subpart 16.1*, (Washington, D.C.: U.S. General Services Administration, September 2001); available from <<http://www.arnet.gov/far>>; Internet; accessed 6 February 2004.

⁷ Part 16 of the FAR and Part 216 of the DFARS describe the types of contracts that may be used in DOD acquisitions. They also prescribe policies, procedures and guidance for selecting the contract type that is appropriate the circumstances of the procurement.

⁸ The contract types addressed are not all inclusive. There are other contract types that apply to specific circumstances that are not normally used for DOD procurement of materiel and services. This research paper limits discussion to the contract types normally used by DOD.

⁹ Department of Defense, *Defense Procurement and Acquisition Policy: Contract Pricing Reference Guides*; available from <<http://www.acq.osd.mil/dpap/contractpricing/vol14chap1.htm>>; Internet; accessed 20 January 2004.

¹⁰ Department of Defense, *Defense Procurement and Acquisition Policy: Contract Pricing Reference Guides*; available from <<http://www.acq.osd.mil/dpap/contractpricing/vol14chap1.htm>>; Internet; accessed 13 January 2004.

¹¹ Ibid.

¹² Department of Defense, *Defense Procurement and Acquisition Policy: Contract Pricing Reference Guides*; available from <<http://www.acq.osd.mil/dpap/contractpricing/vol14chap1.htm>>; Internet; accessed 13 January 2004.

¹³ The PCO's authority rests in his contracting officer's warrant. See FAR, Part 1.

¹⁴ General Services Administration, *Federal Acquisition Regulation, Parts 2 and 12*, (Washington, D.C.: U.S. General Services Administration, September 2001); available from <<http://www.arnet.gov/far>>; Internet; accessed 6 February 2004.

¹⁵ Ibid, Subpart 16.2.

¹⁶ Ibid, Subpart 16.3.

¹⁷ Ibid, Subpart 16.6.

¹⁸ Ibid, Subpart 16.1.

¹⁹ These categories are the author's consolidation of the many DOD, Service and agency policy documents available. See Department of Defense, *Chapter 15, Acquisition Reform*; available from <<http://www.defenselink.mil/execsec/adr1999/chap15.html>>; Internet; accessed 13 January 2004, and Department of Defense, *Defense Procurement and Acquisition Policy*; available from <<http://www.acq.osd.mil/dpap.html>>; Internet; accessed 13 January 2004, and Assistant Secretary of the Army for Research, Development and Acquisition, *Appendix A: Updated Guidelines for Army Acquisition Reform Strategic Planning*; available from <<http://dasapp.saalt.mil/arstrpln/appenda.htm>>; Internet; accessed 4 December 2003, as examples.

²⁰ Ibid.

²¹ Department of Defense, *The Road Ahead: Accelerating the Transformation of Department of Defense Acquisition and Logistics Processes and Practices*, available from <<http://www.defenselink.mil/dodreform/overview/sld003.htm>>; Internet; accessed 4 February 2004.

²² The references listed in endnotes 17 and 19 identify the requirement to reduce overhead costs to both DOD and contractors. While these costs result from many factors, the major causes are the management and administration of the risk to the DOD in obtaining the contract deliverable.

²³ Unique requirements are identified throughout the FAR and DFARS and are too numerous to identify in the scope of this paper. These requirements can be grouped into four general categories that affect the total cost to DOD in selecting contract type. The categories are: price reasonableness, financial management, contract administration and oversight, and contractor payment.

²⁴ Department of Defense, *Defense Procurement and Acquisition Policy: Contract Pricing Reference Guides, Section 1.3*; available from <<http://www.acq.osd.mil/dpap/contractpricing/vol14chap1.htm>>; Internet, accessed 20 January 2004.

²⁵ See Table 1.

²⁶ Defense Contract Audit Agency, *Information for Contractors*, DCAAP 7641.90 (Washington, D.C.: Defense Contract Audit Agency, January 2003), 4-1.

²⁷ Ibid, 4-3, 4-4.

²⁸ Defense Contract Management Agency, *DCMA One Book*; available from <<http://home.dcma.mil/onebook.htm>>; Internet; accessed 7 January 2004.

²⁹ See FAR Part 32, and Defense Contract Audit Agency, *Information for Contractors*, DCAAP 7641.90 (Washington, D.C.: Defense Contract Audit Agency, January 2003), 5-1.

³⁰ See Table 2. See General Services Administration, *Federal Acquisition Regulation, Subpart 16.3*, (Washington, D.C.: U.S. General Services Administration, September 2001); available from <<http://www.arnet.gov/far>>; Internet; accessed on 6 February 2004, and Department of Defense, *Defense Federal Acquisition Regulation Supplement, Subpart 216*, available from <<http://www.acq.osd.mil/dp/dfar/dfars>>; Internet; accessed 6 February 2004.

³¹ Department of Defense, *Defense Procurement and Acquisition Policy: Contract Pricing Reference Guides, Section 1.3*; available from <<http://www.acq.osd.mil/dpap/contractpricing/vol14chap1.htm>>; Internet; accessed 20 January 2004.

³² Defense Contract Audit Agency, *Information for Contractors*, DCAAP 7641.90 (Washington, D.C.: Defense Contract Audit Agency, January 2003), 6-4.

³³ See Table 2.

³⁴ Defense Contract Audit Agency, *Information for Contractors*, DCAAP 7641.90 (Washington, D.C.: Defense Contract Audit Agency, January 2003), 4-3.

³⁵ General Services Administration, *Federal Acquisition Regulation, Subpart 42.3*, (Washington, D.C.: U.S. General Services Administration, September 2001); available from <<http://www.arnet.gov/far>>; Internet; accessed 6 February 2004. The categories are the author's.

³⁶ See FAR Part 32, and Defense Contract Audit Agency, *Information for Contractors*, DCAAP 7641.90 (Washington, D.C.: Defense Contract Audit Agency, January 2003), 5-1.

³⁷ The payment and audit requirements are included in the required contract clauses incorporated into the contract type. See General Services Administration, *Federal Acquisition Regulation, Part 16, and Part 52*, (Washington, D.C.: U.S. General Services Administration, September 2001); available from <<http://www.arnet.gov/far>>; Internet; accessed 6 February 2004.

³⁸ Defense Contract Audit Agency, *Information for Contractors*, DCAAP 7641.90 (Washington, D.C.: Defense Contract Audit Agency, January 2003), 5-11 – 5-14.

³⁹ General Services Administration, *Federal Acquisition Regulation, Subpart 7.1*, (Washington, D.C.: U.S. General Services Administration, September 2001); available from <<http://www.arnet.gov/far>>; Internet; accessed 6 February 2004.

⁴⁰ Department of Defense, *Defense Federal Acquisition Regulation Supplement, Subpart 207.1*, available from <<http://www.acq.osd.mil/dp/dfar/dfars>>; Internet; accessed 6 February 2004.

⁴¹ General Services Administration, *Federal Acquisition Regulation, Subpart 7.1*, (Washington, D.C.: U.S. General Services Administration, September 2001); available from <<http://www.arnet.gov/far>>; Internet; accessed on 6 February 2004, and Department of Defense, *Defense Federal Acquisition Regulation Supplement, Subpart 207.1*, available from <<http://www.acq.osd.mil/dp/dfar/dfars>>; Internet; accessed 6 February 2004.

⁴² Ibid.

⁴³ Defense Contract Management Agency, *DCMA One Book*; available from <<http://home.dcma.mil/onebook.htm>>; Internet; accessed 7 January 2004.

⁴⁴ Based on Fiscal Year (FY) 03 budget estimate. See Undersecretary of Defense, Comptroller, *Defense Fiscal Year (FY) 2003 Budget Estimates, Defense Contract Management Agency*; available from <http://www.dod.mil/comptroller/defbudget/fy2003/budget_justification/pdfs/operation/fy03-DCMA.pdf>; Internet; accessed 20 January 2004.

⁴⁵ Defense Contract Management Agency, *DCMA One Book*; available from <<http://home.dcma.mil/onebook.htm>>; Internet; accessed 7 January 2004.

⁴⁶ Defense Contract Audit Agency, *DCAA Contract Audit Manual*, DCAM Manual 7640.1 (Washington, D.C.: Defense Contract Audit Agency, July 2003), 1-001.

⁴⁷ Undersecretary of Defense, Comptroller, *Defense Fiscal Year (FY) 2003 Budget Estimates, Defense Contract Audit Agency*; available from <http://www.dod.mil/comptroller/defbudget/fy2003/budget_justification/pdfs/operation/fy03-DCAA.pdf>; Internet; accessed 20 January 2004.

⁴⁸ Based on Fiscal Year (FY) 2003 budget estimate. See Undersecretary of Defense, Comptroller, *Defense Fiscal Year (FY) 2003 Budget Estimates, Defense Contract Audit Agency*; available from <http://www.dod.mil/comptroller/defbudget/fy2003/budget_justification/pdfs/operation/fy03-DCAA.pdf>; Internet; accessed 20 January 2004.

⁴⁹ Defense Finance and Accounting Service, *DFAS Contractor Payment Handbook*; available from <<http://www.dfas.mil/commmpay/contractorpayment.htm>>; Internet; accessed 12 December 2003.

⁵⁰ This time frame is dependant on the expiration period of the type of funds obligated for the contract. Funds are no longer available to pay contract disbursements 5 years after they expire. See General Accounting Office, *Cancelled DOD Appropriations: \$615 Million of Illegal or Otherwise Improper Adjustments*, (Washington, D.C., General Accounting Office, July 2001), 5.

⁵¹ Based on Fiscal Year (FY) 2003 budget estimate. Costs allocated to contractor payment include contract payments through the Mechanization of Contract Administration Services (MOCAS) system and the other vendor payment systems. See Undersecretary of Defense, Comptroller, *Defense Fiscal Year (FY) 2003 Budget Estimates, Defense Contract Audit Agency*; available from <http://www.dod.mil/comptroller/defbudget/fy2003/budget_justification/pdfs/operation/fy03-DCAA.pdf>; Internet; accessed 20 January 2004.

⁵² These groupings are the author's based on the analysis of available information during this research.

⁵³ This data was obtained from the DCMA Finance and Business Management Office and is used with permission. Data was converted from labor hours to work years using the standard of 2,080 hours per work year. The Pre-Contractual labor category includes the following sub-categories: Industrial Analysis / Surge Program, Acquisition Planning Support Services, Past Performance Information, Pre-award surveys, and Pre-contract services.

⁵⁴ The FY 2003 budget estimate for DCAA pre-contract services is one man year less than actual FY 2002 effort. Pre-contract assistance are the Forward Pricing and Procurement Support categories. See Undersecretary of Defense, Comptroller, *Defense Fiscal Year (FY) 2003 Budget Estimates, Defense Contract Audit Agency*; available from <http://www.dod.mil/comptroller/defbudget/fy2003/budget_justification/pdfs/operation/fy03-DCAA.pdf>; Internet; accessed 20 January 2004.

⁵⁵ The contract payment instructions are a part of acquisition planning. See General Accounting Office, *DOD Contract Management: Overpayments Continue and Management and Accounting Issues Remain* (Washington, D.C.: General Accounting Office, May 2002), 5-8., and General Accounting Office, *DOD Contract Payments: Management Action Needed to Reduce Billions in Adjustments to Contract Payment Records* (Washington, D.C.: General Accounting Office, September, 2003).

⁵⁶ This anecdotal evidence was apparent throughout this research and is supported by the Author's experience. The author's experience as a DOD PCO, ACO and contract management supervisor over the last 12 years includes many first-hand experiences with contracts containing unnecessary terms and conditions that led to less than best value procurement of materiel and services.

⁵⁷ Inefficient contract terms and conditions for quality inspection and acceptance is an example that is of topical interest in DOD. A recent DOD Inspector General report found widespread inefficiencies for quality inspection and acceptance in DOD contracts. See Office of the Inspector General, *Acquisition: Government Source Inspections (D-2004-011)*, 15 October 2003; available at <<http://www.dodig.osd.mil/audit/reports>>; Internet; accessed 6 February 2004.

⁵⁸ These business processes include financial management systems, accounting systems and practices required to submit price and/or cost proposals and track direct and indirect contract costs, and other systems to comply with DOD oversight requirements. See Edward L. Will, "Paving the Way for Price-Based Acquisition," *Acquisition Review Quarterly* (1999), available from <<http://www.dau.mil/pubs/arq/99arq/will.pdf>>; Internet; accessed 20 January 2004.

⁵⁹ This is the author's opinion. The training programs for DOD acquisition professionals are segmented by the specific part the acquisition professional plays in the process (PCO, ACO, etc.) The author has completed all required DOD training for contracting professionals. During this training, there was insufficient emphasis placed on the acquisition planning process, and the identification of the necessary participation by DCMA, DCAA, and DFAS.

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